

Progress towards a new relationship:

How HMRC is working to make life easier for business

Executive Summary

1. HM Revenue and Customs (HMRC) was established in April 2005 through the integration of Inland Revenue and HM Customs and Excise. The creation of a new department was a recommendation of the O'Donnell Review¹, which identified that small business would gain significantly from dealing with a single department for all their tax affairs. At Budget 2005, a consultation was launched which set out a vision of the service that HMRC aspired to provide for its small business customers, and seeking the views of small business and their representatives as to how HMRC could best capture the benefits of the merger to reduce the administrative burdens imposed by the tax system. This work complemented the Hampton Review², which set out the principles of risk-based inspection and enforcement which should be followed across the rest of the public sector. While HMRC was not within the remit of the Hampton Review as it is not a regulator, it is committed to embedding those principles within its activities.
2. At 2005 Pre-Budget Report HMRC reported on the outcome of the Budget 2005 consultation and on progress in realising the benefits of merger, through a series of short and longer term work programmes. This paper provides a further update on how this important work is moving forward.
3. In Budget 2005 HMRC also committed to setting stretching targets for reducing the administrative burden on business. As a first step, and in order to get a more complete understanding of all businesses' experience of the tax system, HMRC commissioned KPMG to measure the administrative burden that the tax system imposes on business. HMRC is now using that research to set targets to reduce further the administrative burdens on business, building on achievements so far. This paper explains how HMRC will work alongside business and business representatives to develop priorities for further action.

Measuring the burden

4. The KPMG research was based on a methodology developed in the Netherlands that has since been used in Denmark, and following the UK Presidency this approach will be adopted more widely across the EU. The methodology involved close working and consultation with business at all stages. KPMG enlisted the help of an Advisory Board comprising key members of business organisations as well as people with hands-on experience of running businesses in the UK to bring a business perspective to the project.

¹ http://www.hm-treasury.gov.uk/budget/budget_04/associated_documents

² http://www.hm-treasury.gov.uk/consultations_and_legislation/hampton/consult_hampton_index.cfm

5. This substantial piece of work involved identification of all the information obligations that tax legislation imposes on business and contact with around 1,000 businesses and their agents to gain estimates of time taken for tasks, which fed into all calculations. These costs can be analysed by tax, by business size or by type of task.
6. The KPMG model offers rich management information that can be used to target particular drivers of administrative cost. Using this data as the basis for an ongoing dialogue with business and their representatives, the future work to reduce unnecessary administrative burdens and complexity in the tax system can be informed by objective analysis and evidence.
7. Another benefit of this approach is that it allows comparisons of the administrative burdens of the tax system as a percentage of GDP or tax take with percentages calculated on a similar basis in other countries that have used the same method. Compared with both the Danes and Dutch, the only other countries that have so far used this approach across government regulation, the UK compares well, at approximately 0.41 per cent of UK GDP, or 1.1 per cent of tax take. The corresponding figure for the Netherlands was 0.82 per cent, or 2.1 per cent of tax take, and for Denmark 0.57 per cent, or 1.2 per cent of tax take. Other countries are engaged in a similar exercise and will be reporting their results soon.
8. The relatively low UK figures reflect well on the historic approach taken in the UK tax system, and demonstrate the benefit of the steps already taken to reduce the burden on business. The relatively higher figures in Denmark and the Netherlands are accounted for by a number of requirements which either have never been imposed on business in the UK, or have already been removed as part of ongoing simplification efforts. These include the separation of responsibility for tax and social security payments, audit and VAT thresholds much lower than those of the UK, and requirements to make VAT returns more frequently. In contrast, the UK already has one of the highest thresholds in the EU for VAT registration, exempting more than 2 million businesses from dealing with VAT, and a high audit requirement threshold. Small businesses can choose to file VAT returns quarterly rather than monthly, and HMRC has introduced shortened tax returns for smaller businesses and made many essential business services available online.

Priorities for action

9. Although the UK has a baseline that has already benefited from a number of deregulatory reforms, the creation of HMRC offers significant opportunities to deliver further reductions in administrative burdens. No tax system will ever be free from administrative burdens, and it is clear from the data that there is a complex picture that underpins the headline results. For example, the research indicates that 85 of the 2,692 obligations impose 85 per cent of the total administrative burden. Those 85 include dealing with the main tax returns and forms. HMRC

will therefore target a reduction in the burden of dealing with forms and returns, starting with the self assessment return completed by 3 million businesses, and with the partnership return, filled in by 600,000 others.

10. The research also indicates that there is a long list of obligations which, whilst adding little to the overall administrative cost (because they apply to relatively few businesses, or are triggered only by specific events) contribute to a picture of complexity and include a high “irritation” factor. And they can be costly to deal with for individual businesses. An example of this is HMRC’s inspection and audit regimes. Responding to previous business feedback, HMRC announced changes to those regimes at Pre-Budget Report, including a redesign of its inspection and audit processes to reflect the needs and practice of modern business. Responding to the business people and their representatives involved in the KPMG work, and to the views of the Advisory Board, HMRC is today setting a target to reduce the burden in this area.

Administrative Burden Advisory Board

11. HMRC wants to continue to work with business to identify priority areas for action. This approach has recently worked well in the context of both stamp duty land tax and the alcohol duty excise regime which demonstrated the scope for streamlining of the system, thereby making it easier for business to understand and reducing uncertainty. Building on this approach, which has today seen more than 40 out of date pieces of excise duty legislation withdrawn or simplified, HMRC is setting up an Administrative Burden Advisory Board. The Board will include business representation and be chaired by Teresa Graham OBE, chair of a number of SMEs and deputy chair of the Better Regulation Commission; it will oversee this work and help identify priorities. This group will subsume HMRC’s existing Small Business Advisory Group.

New targets

12. HMRC’s new targets are therefore:
 - to reduce by at least 10 per cent the administrative burden on business of dealing with HMRC forms and returns, over a 5 year period; and
 - to reduce the administrative burden on business of dealing with HMRC’s audits and inspections by 10 per cent over 3 years, and at least 15 per cent over 5 years.

HMRC will go further. Working with the new Advisory Board and in consultation more widely with business, HMRC will identify priority areas of the tax system for streamlining and modernisation. This approach will ensure that HMRC focuses both on the areas that contribute significantly to the overall UK baseline, such as the main business forms and returns, and on

those burdens that, while significant and burdensome for the small number of businesses that are affected, are not a cause for concern for the majority of businesses.

Update on progress

13. The KPMG research and HMRC's new targets build on the work announced at PBR in HMRC's paper *"Making the new relationship a reality"*. This paper sets out progress against HMRC's vision, that business should:
 - provide information only once;
 - spend less time dealing with inspection;
 - benefit from a range of flexible payment options;
 - have a single point of contact with HMRC; and
 - receive support, education and guidance at the time they need it most.

14. Since Budget 2005 HMRC has made a number of important strides in achieving that vision, including progress in delivering the £300 million savings announced at Pre-Budget Report last year. These include:
 - the transfer from employers to HMRC of the responsibility for paying tax credits to employees;
 - the introduction, in April 2006, of a new form P46, which will cut enquiries to employers about their employees' tax affairs by one million;
 - removing 90 per cent of new companies from the requirement to fill in Form 42 (on which employers annually report their transactions in employment-related securities); and
 - completion of the consultation with business on aligning filing dates for accounts and returns between HMRC and Companies House.

15. HMRC will also continue to work in partnership with HM Treasury to look for measures to make the tax system easier for small business to understand and administer. In Budget 2006, the Chancellor has announced that he will respond to representations to examine the scope for further alignment of income tax and national insurance contributions with a view to bringing forward proposals for consultation.

Section 1

History

- 1.1 This paper is about the foundations HM Revenue and Customs has laid and the progress made towards its goal of transforming its relationship with small business.
- 1.2 Small business was identified as the customer group with most to gain from the creation of an integrated tax department in April 2005 (following the recommendations of the O'Donnell Review). In Budget 2005 HMRC launched "*Working towards a new relationship*"³ - a consultation with small and medium businesses and their advisers to find out what business really want from a modern tax authority and their views on how the new department should use its limited resources to best effect. That document was set in the context of Philip Hampton's review into the inspection and enforcement of government regulations and adopted the same principles. By the 2005 Pre-Budget Report, HMRC had embarked on a programme of improvement work and published a paper "*Making the new relationship a reality*"⁴ on the outcomes of the consultation.
- 1.3 Since then, responding to the priorities that emerged from the consultation, HMRC has been undertaking a programme of work that will help to make a real difference to business in dealing with tax. This paper is a further update on that work.

How is HMRC responding to businesses' priorities?

- 1.4 HMRC is focusing its simplification agenda on the areas that cause business most difficulty, and looking at any improvements that make it easier for business to comply. The Department's vision is that businesses should: need to provide information only once; spend less time dealing with inspections; benefit from a range of flexible payment options; enjoy a single point of contact with HMRC; and receive clear and targeted support, education and guidance at the time it is needed most. Work is also underway to improve the rules and streamline legislation where it proves possible and will make a noticeable difference.
- 1.5 This work ranges from removing redundant pieces of legislation, for example today's announcement of the withdrawal or simplification of more than 40 pieces of out of date excise legislation, to changing fundamentally the way the Department does things, such as the successful transfer from employers to HMRC of payment of tax credits. There is more on this work in Section 2.

³ http://www.hm-treasury.gov.uk/budget/budget_05/other_documents/bud_bud05_odrelationship.cfm

⁴ http://www.hm-treasury.gov.uk/budget/budget_05/other_documents/bud_bud05_odrelationship.cfm

Costing the administrative burden

- 1.6 HMRC's 2005 remit from the Chancellor required the Department to develop and agree with HM Treasury stretching but realistic targets for reducing the administrative costs imposed by HMRC on small business, including a baseline against which progress can be measured. HMRC therefore mapped all regulations that place an obligation on business during summer 2005, and appointed KPMG to research and model the burden.
- 1.7 The primary purpose of tax legislation is to raise national revenue. HMRC is a tax authority not a regulator. Nevertheless, HMRC decided to use the "Standard Cost Model" (SCM) to measure the burden on business that had been recommended in the report *"Regulation - Less is More"*⁵ by the Better Regulation Task Force, the method previously used by the Dutch and the Danes. HMRC's exercise has been separate but parallel to the main cross-government exercise being overseen by the Better Regulation Executive in the Cabinet Office.

What has the exercise found?

- 1.8 In recent weeks, HMRC has been discussing with KPMG early trends emerging from the data. These suggest an administrative burdens total cost of around £5 billion a year. This represents 0.41 per cent of GDP or 1.1 per cent of tax take and compares well with results in other countries that have undertaken similar exercises: 0.82 per cent of GDP, or 2.1 per cent of tax take, in the Netherlands, and 0.57 per cent of GDP, or 1.2 per cent of tax take, in Denmark. This reflects the fact that the UK tax authorities, as part of ongoing efforts to reduce administrative burdens, had already implemented a number of measures before the 31 May 2005 measuring date, that the Dutch and the Danes implemented after theirs. Examples include merging collection of income tax and social security payments, allowing smaller businesses to file VAT returns less frequently, and a high VAT and audit threshold. It is also consistent with a recent NAO report into the UK's corporation tax system⁶.
- 1.9 But although the relative burdens in the UK compare well with other countries, there is more that can be done. HMRC is therefore setting targets to build on what has already been achieved, to respond to business priorities, and to use the KPMG data as it is produced and analysed to drive progress faster.
- 1.10 A key finding of the KPMG research shows that only 85 of the 2,692 obligations cause 85 per cent of the total cost. This small number of obligations includes the fundamental building blocks of tax compliance – for example, all businesses complete the major forms and returns. But there are more than 2,600 other requirements which, while small individually in cost terms, are what

⁵ <http://www.brc.gov.uk>

⁶ http://www.nao.gov.uk/publications/nao_reports

businesses say give them greatest cause for concern. This is partly because the long list of burdens contributes significantly to the perception of “complexity” of the tax system, even though they may impact on only a minority of businesses. Included here, for example, are HMRC’s audit and inspection regimes which, while adding little to the overall burden, can be onerous and costly at individual business level.

- 1.11 The research included interviews with around 1,000 businesses of different sizes. Targeted interviews were held with businesses with specific areas of expertise, and focus groups were held with a number of agents representing a range of businesses. The research captured much of their feedback and provides a real flavour of the views expressed to focus future work. These are broadly structured around business wanting to know why a thing has to be done, knowing what they have to do, doing it, and how HMRC interacts with them throughout the whole process. The Department will need to study this analysis closely, but there are clear messages from business about where HMRC needs to improve.
- 1.12 Some interviewees appreciated HMRC’s simple forms such as the P45 (containing latest pay and tax details) or the short self assessment tax return. Others identified areas for improvement such as the self assessment return self-employment pages. There was positive feedback about some of HMRC’s business and employer workshops, and the CD-ROM for employers, but the variability of HMRC’s customer services and the “fear factor” of having to deal with a tax authority were also highlighted as significant potential concerns.

What next?

- 1.13 HMRC’s challenge between now and the Pre-Budget Report is to continue with the current programme of work to reduce the burden on business of dealing with the tax system, and start using the results of the KMPG exercise to inform that work. Volume 1 of the report will be published by Easter 2006.
- 1.14 To focus this work the department will:
- reduce by at least 10 per cent the administrative burden on business of dealing with HMRC forms and returns, over a 5 year period, starting with the self assessment return filled in by up to 3 million businesses, and the partnership self assessment return; and
 - reduce the administrative burden on compliant businesses of dealing with HMRC’s audits and inspections by 10 per cent over 3 years, and at least 15 per cent over 5 years.

HMRC will also broaden the Small Business Advisory Group, establishing an Administrative Burden Advisory Board, to be chaired by Teresa Graham OBE, chair of a number of SMEs and deputy chair of the Better Regulation Commission, to oversee and help prioritise this work.

Tackling the long list of requirements that are not among the most burdensome obligations must be a priority if businesses are to feel that the system has been improved for them. HMRC has made a start in targeting a reduction in the burden of inspections and audits. By working closely with business HMRC will be able to identify and prioritise more areas that businesses themselves want reformed. The Department will therefore be working with the new Administrative Burden Advisory Board to take forwards the approach piloted for the excise, alcohol and stamp duty regimes that has today seen more than 40 out of date regulations withdrawn or simplified.

Section 2: Reducing the burdens on business

2.1 As explained in our last paper *“Making the new relationship a reality”*, HMRC has embarked on an ambitious programme of work, which over the coming years will deliver real benefits for business – freeing up time and resources for people to use running their businesses. This paper provides an update on that programme of work, and explains how the KPMG data will help take it forwards.

2.2 HMRC’s vision is that, in the longer term, business will:

- **provide information only once;**
- spend **less time dealing with inspections;**
- benefit from a range of **flexible payment options;**
- enjoy a **single point of contact** with HMRC; and
- benefit from clear and targeted **support, education and guidance** at the time they need it most.

Complexity and “Irritation Factor”

2.3 The KPMG research indicates that a small number of obligations impose the majority of the administrative burden on business of dealing with the tax system. These include the fundamental building blocks for administering a tax system such as the main business forms and returns, and VAT invoices. It is essential to continue to bear down on these costs (as we have done with the shortened tax return for self assessment, and through freeing 90 per cent of new companies from filling in Form 42) and we are setting a target to do so. It is also important to tackle some of the large number of other obligations which are individually burdensome, although they impact on fewer businesses, as these contribute to the complexity of the tax system and feature in many of the representations made to HMRC. We need also to improve our services, and work with business to make UK tax administration more modern and streamlined.

Providing information only once

2.4 We continue to work towards our goal of making greater use of the information that we already hold, and integrating our systems so that businesses have to provide the same information only

once for all their tax affairs. In the longer term our **Whole Customer View** programme will deliver real benefits here (more on this at paragraph 2.40).

Simplifying Forms and Returns

Annual tax returns and statements

- 2.5 The KPMG research showed that among the heaviest burdens placed on business is dealing with the main tax returns - the income tax self assessment return, the partnership return, and the company tax return. We are tackling all three. For the **self assessment return**, we will pilot a new, shorter and simpler form with up to 12,500 people, including around 5,000 businesses, in April 2006. The new form contains fewer questions and uses clearer language with simpler guidance, and the self-employment section is reduced by half for those small businesses with a turnover of less than £40,000 a year. Around 2 million of the 3 million businesses which currently fill in the form will benefit from the new version when fully implemented in April 2008, of which around 500,000 will benefit from the shorter self-employment section.
- 2.6 For the **partnership return**, we are planning, with business, an in-depth review to establish the main drivers of the burden and how we might reduce them over time. This should benefit up to 600,000 partnerships.
- 2.7 For **corporation tax**, in 2004 we introduced a short 4-page CT600 return form suited to most companies with straightforward tax affairs. Companies whose tax affairs are more complex use an 8-page form. The KPMG work identified the computation of taxable profit as particularly onerous for business. Here we are evaluating recent pilots of an online **Active Computational Tool** that will help small companies with simple affairs to prepare the computations needed to complete their returns. Early feedback has been variable so we are looking at how we could improve the system for business. In addition, our corporation tax online filing service is now able to accept computational data in XBRL format. By adding computer “tags” to financial data (akin to bar coding) XBRL is designed to streamline end-to-end financial reporting processes. The full benefits for companies and accountants will be achieved when business software systems are upgraded to produce XBRL, and we are working with XBRL UK Ltd, professional bodies, accountancy firms and software suppliers to help bring this about.
- 2.8 We have also been working on making the **self assessment statement of account** (the tax bill for self-employed businesses) easier to understand. In August 2006, we will introduce a new style self assessment statement that will provide customers with a clearer and more direct account of their liability, enabling easier understanding when dealing with each statement.
- 2.9 Many businesses choose to deal with HMRC through an agent or other tax adviser and many of these want to deal with HMRC online. Agents have told us that the main obstacle to online filing of their clients’ self assessment returns is that it is not possible to **attach documents to the**

return. Agent online filing is up by 97 per cent this year, but many still continue to complete the return online using proprietary software, print it out and then send it to HMRC with the other paper documents attached. This causes more work, wastes time and adds costs. So during 2006-07 HMRC will deliver a new facility to allow documents to be attached to self assessment returns filed online. This should streamline the process for agents and reduce the costs to business and HMRC overall.

- 2.10 In total we received 1.99 million self assessment tax returns online by the 31 January deadline, an increase of 24.4 per cent on last year. We received 258,000 returns in the last five days, against a forecast of 240,000. The system performed well, at the peak time processing almost 150 returns per minute. We continue to invest in securing the robustness and reliability of our online services.
- 2.11 In addition to being able to **file VAT returns** on our web site, we are extending the service later in the year to enable businesses and their agents to file VAT returns direct to HMRC from their accounting software, removing the need for any paper, separate online login or filing.

Increasing the use of online services

- 2.12 In July 2005, the Paymaster General commissioned Lord Carter of Coles to conduct an independent review of HMRC's online services, in order to realise benefits for HMRC's customers and to ensure sustainable and efficient service delivery, whilst continuing to support compliance. Lord Carter's review is published today⁷. He has concluded that well-designed online services can bring benefits to taxpayers and the Government. The Government agrees with his aspirational goal of universal electronic delivery of HMRC tax returns from businesses and IT-literate individuals by 2012, and accepts his recommendations.
- 2.13 HMRC will continue to invest in its online infrastructure and supporting systems to deliver robust, high capacity services, which will be rigorously tested. Subject to these services being in place:
- businesses will be required to file their VAT returns, Pay As You Earn (PAYE) in-year forms (the P45 and P46), and corporation tax returns online in phases from April 2008;
 - with effect from 2008, filing deadlines for income tax self assessment returns will be by 30 September on paper, or 30 November online, with the enquiry window linked to the filing date, to encourage early online filing; and
 - from April 2008, agents' computer-generated paper "substitute" returns for income tax self assessment will no longer be accepted.

⁷ www.hmrc.gov.uk

We will work with businesses, taxpayers, software developers, agents and other intermediaries on the implementation of these changes, which will not affect the smallest existing self-employed businesses until at least 2012.

- 2.14 Initial analysis of the KPMG research shows that business will benefit from these recommendations as electronic filing is found to be generally popular among business (particular praise was given to payroll online filing) and that they would like it to be used more widely. This is thought to be because business find online filing more convenient, as the electronic return can be filed up to the due date without having to factor in postal time. Business will also benefit from time savings from other aspects of online filing such as automatic calculation, reduced need for telephone contact to check the return has been received, and correction of errors. Adopting IT can also produce wider business benefits such as streamlined accounting and invoicing and improved access to information, customers and new markets.

Companies House Consultation

- 2.15 The period for consultation on aligning filing of the company tax return and delivering accounts to Companies House closed on 3 March 2006. We received a high level of engagement, with over 100 written responses received. These have shown a divide between the comments of smaller companies and their larger counterparts. Generally, where a company or its agent draws up its accounts and tax computations more or less in tandem with each other, the response has been favourable. However, where there is a separation between compiling accounts and the tax computations based on them, as is usually the case in larger businesses, the response has been more negative. We are continuing to explore with interested parties how to reconcile these messages and secure the deregulatory gain for small and medium businesses without imposing unrealistic obligations on large companies.

Employer forms

- 2.16 One of the most burdensome forms identified by KPMG was **form P46** (completed by employers when they take on staff who are unable to produce form P45 containing their latest pay and tax details). From April 2006 we are launching a new form P46 which will increase by one million the number of new employees with an initial tax code appropriate to their circumstances, reducing the number of queries employers receive from their employees about their tax affairs.
- 2.17 Consistent with previous feedback, business also said that they found it time-consuming and difficult to complete **form P11D**, the employer's return of benefits and expenses received by an employee. HMRC believes that a significant number of these forms would not be necessary if more employers applied for a dispensation. This would help employers who reimburse business travel and other costs borne by the employee, which without a dispensation need to be reported

on a P11D and then claimed as allowable for tax by the employee. Up to now HMRC has made employers aware of dispensations through a general message. In future we will target guidance towards those employers most likely to benefit on the basis of their past entries on the form. We are also planning to enhance the HMRC web site and the Employer CD-ROM to better signpost our guidance around the P11D process to eliminate other unnecessary work by employers.

- 2.18 We were also told of frustrating delays for employers in HMRC's processing of the forms, and consequently in amending employees' PAYE codes. Staff processing P11Ds from May 2006 will benefit from a software tool, which **automatically calculates coding adjustments** and restrictions, and ensures the right code on the basis of the information supplied in most P11Ds. We expect that this change will improve accuracy significantly.
- 2.19 Businesses told us of their concerns about the work involved in completing **Form 42** (on which employers annually report their transactions in employment-related securities). The KPMG research indicates it is amongst the most burdensome forms to complete in terms of time taken. We have already removed the obligation for businesses to submit a form for the first issue of shares in the majority of cases. We expect that this change will give rise to a reduction in excess of 90 per cent in the number of forms requiring completion by new companies. For those companies that do need to complete it, we shall introduce a new interactive combined guidance and form package on the Employer CD-ROM to be issued early in May 2006, making completion easier.
- 2.20 April 2006 will see the successful completion of the transfer from employers to HMRC of the payment of tax credits. The transfer has been widely welcomed by business and the process has proceeded smoothly. Also in April 2006, we will deliver a major reform and simplification of pension tax regimes, which will make pensions schemes simpler and easier to administer and understand.

Facilitating trade

- 2.21 Comments made to KPMG during their research indicate that some firms avoid specific markets and sales because much of the administration is deemed a burden, and that the main irritation is having to understand the requirements and how they change for different countries. Steps to improve this position are already in hand. HMRC is creating a **Single Frontier Change Programme** to deliver enhancements to trade facilitation and threat reduction. A major focus to 2012 will be a simplified paperless import/export environment through delivery of linked electronic customs systems sharing data throughout the European Union (EU). This standardisation is a key step in facilitating EU-led International Trade regulatory changes such as the Export Control System and the Import Control System. It will provide harmonised data, electronically, and will ensure that the data provided to customs authorities anywhere in the EU is uniformly presented.

- 2.22 HMRC recently successfully delivered the third stage of the **New Community Transit System**, adding electronic enquiry handling between Member States to the existing system, benefiting business by speedier resolution of enquiries and discharge of guarantees. In addition, a further extension of the electronic transmission channels available to customers is planned in April 2006. The introduction of this XML channel will improve reliability of messaging from businesses to the new system.
- 2.23 Next year sees the introduction of greater standardisation of the data required on EU import/export documents, systems changes to facilitate correct treatment of goods arriving from new Member States and the first stage of the **International Trade Single Window (ITSW)** to speed up clearance of horticultural goods by providing an electronic link between HMRC and the Department for Environment, Food and Rural Affairs. This will remove the need for the documentary checks which HMRC currently undertakes. Trade costs associated with the presentation of paper documents will be removed. Communicating these intervention requirements electronically will lead to improved clearance times to the trade over the current manual procedures. The ITSW will also enable HMRC to identify non-compliant traders more easily.
- 2.24 Consultation with business, trade bodies and advisers is underway to identify opportunities to reduce the burdens faced by business, particularly SMEs, that trade across borders and have to comply with differing VAT rules in different countries. Information from the KPMG research will inform this new exercise.

VAT registration

- 2.25 Following National Audit Office recommendations in July 2005, HMRC has been exploring a number of options to improve the VAT registration process. This includes re-examining the information we currently ask for at registration and understanding how this information fits with the unified registration concept proposed by the Whole Customer View programme (paragraph 2.40 below). Improved training has been given to staff to help them process registration applications more efficiently, and compliance experts have been appointed to help speed up identification of fraudulent applications. In the medium term, the entire VAT registration process will be reviewed to see where it can be improved and made more efficient. This will enable us to provide a demonstrably better quality of service to customers by introducing processes that are clearer and easier for businesses and staff to understand and reducing backlogs.

Spending less time dealing with inspections

- 2.26 The Hampton Review⁸ set out the principles of risk-based inspection and enforcement that should underpin all activities by regulators across the public sector. HMRC is committed to embedding those principles within its day-to-day activities, building on the many examples of good practice already developed by the predecessor departments. This will result in better targeting of HMRC's inspections, and consequently less burden on businesses with a good tax record.
- 2.27 Feedback from the Review of Links with Medium-sized Businesses⁹ independently concluded that a high proportion of businesses are compliant, and the overwhelming majority believe that HMRC should strongly pursue those seeking a competitive advantage through non-compliance. The Review also found that businesses found dealing with audits and inspections stressful and time-consuming. That is backed by the findings from the KPMG research.
- 2.28 HMRC has an important role in ensuring a level playing field for all business, and in tackling those that seek an unfair advantage. This needs to be done by targeting resource at the areas of highest risk, and using interventions proportionate to that risk. That is why HMRC has set the challenging target of a 15 per cent reduction over the next 5 years in the burden on compliant businesses of dealing with our audits and inspections, with a 10 per cent reduction in 3 years.
- 2.29 HMRC has already committed to adapting the "one size fits all" direct tax enquiry process to a broader range of targeted interventions that better match the different types of risk. Working closely with developments on the New Management Act (paragraph 2.54), the ongoing review of HMRC's Powers, Deterrents and Safeguards aims to provide a framework of law and practice that supports the Government's objectives of a tax system that is fair and better adapted to the needs of customers. The review also aims to consider the scope for aligning and rationalising existing powers so as to make it easier for individuals and businesses to comply with their tax obligations and receive the tax credits to which they are entitled. A consultation will be published shortly on modernising HMRC's legal powers, which will outline new approaches to the way we support compliance by businesses and deter and detect non-compliance.
- 2.30 As part of this approach, HMRC has been working on a range of new compliance interventions that will be flexible and less cumbersome, and reduce the burden on business. More details will be published in the consultation and the views of business sought on six possible new interventions:

⁸ http://www.hm-treasury.gov.uk/consultations_and_legislation/hampton/consult_hampton_index.cfm

⁹ <http://www.hmrc.gov.uk/pbr2005/medium-business-links.pdf>

- A short risk review - targeting risks in specific trades or industry groups and, by working with the business, correcting minor errors in the current return and putting things right for the future;
- A self audit - to resolve general areas of lower level risk in a more cost-effective manner, enabling businesses to correct errors themselves by asking them to look at specific entries on their returns;
- A real-time record review - that will help businesses by reviewing their current records for all taxes to correct any mistakes, enabling more confidence that the return will be accurate;
- A real-time health check - that will identify risk or general issues among specific trades by offering targeted support to enable businesses to submit correct returns;
- Telephone enquiries - contacting businesses selected by data-matching and risk assessment to correct omissions or errors in returns;
- Correction challenge - where quality information with a good confidence in its accuracy is held we will simply correct the error or omission, informing the business of the reason.

2.31 In addition, HMRC is continuing to modernise the way it carries out enquiries. The use of secure **electronic work rooms**, first piloted in Cardiff, where enquiry correspondence is posted to a safe, discrete, e-room is being extended in 2006-07. The pilot proved popular with business, agents and HMRC staff as they were able to work issues more quickly and in “real time” (for example, each party being able to work on the same set of computations, and see what the other had changed, online, rather than sending hard copy computations in the post) leading to reductions of up 20 per cent in the time taken to complete enquiries.

2.32 In response to a recent National Audit Office report¹⁰, HMRC has committed to improve its **risk assessment processes**, leading to fewer enquiries into the returns of compliant businesses. In the summer, HMRC will be publishing a National Risk and Re-engineering Strategy, in the light of the consultation, that will set out how we will achieve that together with:

¹⁰ www.nao.org.uk/publications/nao_reports

- outcomes of the consultation on the new interventions described in paragraph 2.30;
- a national risk strategy; and
- an education and support strategy building on the successes of the business education and support teams from the previous two departments.

2.33 In addition, we are extending the use of an electronic payroll analysis tool that allows fast and detailed analysis of business records. It allows most of HMRC's tests and checks to be carried out prior to the visit to the business premises which will reduce business burdens by saving them time and money in dealing with HMRC inspections. Pilots are now being extended to businesses with more than 20 employees.

2.34 Overall this means businesses that are compliant will be at much lower risk of selection for inspection and audit.

Flexible payment options

2.35 Cash flow is critical for small business. Late payment and non-payment by customers are significant contributors to business failure. In the longer term we are exploring the possibility of a single account across all our business tax regimes, which would allow set off and a single view of the tax account for business customers, their agents and HMRC staff. In the shorter term we continue to widen eligibility to current flexible payment schemes.

Increases to thresholds of simplified VAT schemes

2.36 The VAT schemes already provide some flexible payment options for small business and from April 2006, the maximum turnover limit for joining the VAT Annual Accounting Scheme will increase from £660,000 to £1,350,000, making more than 1.1 million businesses eligible to pay VAT by instalments. At the same time, the rule which prevents businesses with a turnover above £150,000 from joining the scheme in their first year of registration will be removed. Subject to derogation from EU rules, the turnover limit for joining the Cash Accounting Scheme will also increase from £660,000 to £1,350,000. Almost three quarters of a million businesses are eligible for the scheme which ensures that VAT is payable to HMRC only when a business is paid by its customer.

Improvements to Debt Management

2.37 The single customer account mentioned at paragraph 2.35 is still some way away but the Debt Management and Banking arm of HMRC already aims to help businesses facing temporary financial difficulties through arrangements for settling debt by instalments, on a 'whole view'

basis. This holistic approach is also applied to a significant number of telephone calls that focus on education as well as debt management, with the aim of helping businesses comply.

- 2.38 At the moment payment by debit card is limited to use only in pursuit of debt and for payment of income tax self assessment liabilities. We are looking to extend the use of payment by debit card across a broader range of taxes giving customers more choice in how they make payments.
- 2.39 Direct debit is a popular payment channel, widely used by financial and debt management organisations, and efficient and reliable in delivering both business and customer service benefits. For instance, over 50 per cent of customers liable to Class 2 national insurance contributions already use the direct debit method for payment. We are looking to upgrade our direct debit capability and expand capacity to enable the service to be offered to all HMRC customers.

Single point of contact

Whole Customer View

- 2.40 The concept of a whole customer view underpins many of the improvements planned in the medium term. The overall vision is that business will:
- have easy access to a clear and complete picture of their affairs with HMRC, including payments, liabilities and entitlements;
 - be able to deal with HMRC easily, efficiently and effectively across the range of their affairs in the ways that suit them; and
 - know how to get help, and will get the right support and guidance for their circumstances.
- 2.41 During 2005-06 HMRC carried out more feasibility work, looking at costs and benefits both for customers and HMRC of a wide range of options. We have started informal consultations with business and representative bodies to prioritise and put together plans for development and implementation. Those plans will include changing how we carry out our business, and potentially involve substantial change to our computer systems.
- 2.42 HMRC has focused on a few areas initially because they provide the basis of the new more customer-focused approach. These areas are:

- **Unified Registration** – a single process so businesses can register for one or more HMRC regimes according to circumstances and need not repeat information for future registrations;
- **Change of Circumstances** – meaning a business needs to tell us only once of any change in basic information about the business, such as business name, address or agent; and
- **Contact Management** – HMRC maintaining a full record of the contacts and interactions with the business.

2.43 HMRC is about to start an intensive period of further development of these areas, as well as developing a better understanding of the wider range of options (such as single account, unified debt management) so that decisions can be taken in the summer about which present best value for the taxpayer.

Support, Education and Guidance

Better information for our customers

2.44 A recurring theme in the responses to the consultation exercises in 2005, and also emerging from an early look at the KPMG research, is the need for HMRC to improve the information that it provides to support its customers. This is not just a benefit to businesses using our services: a key part of HMRC's 2005 remit is to make it as easy as possible for business to understand and comply with their obligations.

2.45 HMRC is developing a long-term programme of improvements to some key channels of communication with business:

- Following an **independent review of the HMRC web site**, focused on the experience of HMRC's customers, some quick wins were identified and are being implemented. These include dating page changes to web site guidance. Other short-term improvements are in the pipeline, such as decluttering the material on our site, and making it easier to find relevant information. We have also commissioned a second stage of work to help design a better site user interface.
- As part of our longer-term **Strategic Web Content Review** we are studying how information is presented on our web site. We have taken the first steps towards completely overhauling the site so that it is clearer, simpler and more comprehensible, with improved navigation.
- We are proceeding with our **biennial form review process** that will enable us to deliver up-to-date and accurate forms to our customers to recognised standards - encompassing

clarity, customer ease, simplicity and other elements of best practice. Our approach is in line with NAO, wider government, and industry aspirations. A key objective is to apply the lessons learnt from reviewing direct tax forms to indirect tax forms, to facilitate HMRC consistency.

- To help with completion of Form 42 - the form on which employers report their transactions in employment-related securities each year - a new interactive combined guidance and form package will be available on the **Employer CD-ROM** to be issued in early May 2006. This will also include improved calculators for Statutory Maternity Pay and Statutory Sick Pay and new calculators for Statutory Adoption and Paternity Pay. The new interactive P11 working sheet helps employers without payroll software to calculate and record more easily and more accurately the weekly or monthly tax and national insurance deductions from their employees' pay.
- In November 2005 we launched the '**Getting Started in VAT: Guidance for small businesses**' **CD ROM** providing basic, easily accessible information for businesses thinking of registering for VAT and those that are newly registered. It will help approximately 250,000 small businesses applying to register for VAT each year. Business feedback has been extremely positive.
- So that busy small businesses can have more accessible ways to get involved in consultation on policy and implementation issues, we are piloting use of electronic work rooms to ensure that their needs and practical concerns are taken into account.

Other developments

- 2.46 We acknowledge that there is a close correlation between **customers' experience** of dealing with HMRC and their compliance with their obligations. We know many customers want to comply but are unsure of what to do, or where to find appropriate help. We are developing a business education and support strategy for small and medium business customers, based on research of customer needs. We are also working with the business community to draw up a standard, to be published later this year, setting out what our customers tell us are their needs and how their experience of dealing with us can be improved. This standard will drive improvements in the services we offer to our business customers and the way those services are provided.
- 2.47 In 2001, under the sponsorship of HMRC Director General Dave Hartnett, the then Inland Revenue undertook a **Review of its Links with Business**. This focused predominantly on links with large business, resulting in the creation of the Business Tax Forum with a remit "to foster a stronger relationship between large business and HMRC/HMT to improve the administration of the tax system and increase mutual understanding". As one of the first initiatives of the new

department, last year HMRC undertook a successful review focusing on medium-sized business¹¹, which led to the re-engineering of HMRC's enquiry process (more details paragraph 2.30) and a greater voice for entrepreneurial medium businesses which has led to the proposed increases in the thresholds for R&D tax credits (paragraph 2.50).

- 2.48 Following the success of these two reviews, HMRC is today announcing a follow-up to the Review of Links with Large Business that will evaluate progress since 2001, consider opportunities to build on the success of the Business Tax Forum and seek to identify further scope to enhance the relationship between large business and HMRC in respect of the implementation of tax policy and the administration of the tax system.
- 2.49 In the Pre-Budget Report we announced improvements to the administration of the **Research and Development (R&D) tax credits** scheme, including the creation of dedicated R&D units within HMRC to ensure greater consistency. We expect to have these specialist teams in place and operational before the end of 2006, making it easier for businesses to claim their entitlements.
- 2.50 HMRC also committed to reviewing whether there were cost effective enhancements to the R&D tax credit that would not compromise its simplicity, stability and certainty. The Review of Links with Medium-sized Businesses found that the lack of recognition of medium business could be an obstacle to their growth. Recognising these concerns and other evidence, the Government is today announcing additional support to this sector. Subject to the outcome of state aid discussions with the European Commission, additional support will be extended for companies above the current SME threshold to up to double that size. This will be a real boost to the sector and will increase support for over £200 million of qualifying R&D in the UK.
- 2.51 HMRC is reforming the **Construction Industry Scheme (CIS)** to reduce the administrative burden on business and provide electronic alternatives to current paper-based processes. From April 2007, CIS cards and certificates will be discontinued so that subcontractors will no longer have to travel, sometimes long distances, to present their documentation in person for contractors to inspect. Individual vouchers will be replaced by a contractor's monthly return which should reduce the burden for both subcontractors and contractors. In addition, contractors will no longer have to complete an end of year return.

¹¹ <http://www.hmrc.gov.uk/pbr2005/medium-business-links.pdf>

Making the rules easier for business

2.52 Tax legislation which is hard to understand promotes uncertainty and leads to higher costs of compliance. Where possible, HMRC aims to rewrite legislation in a form that is clearer and easier to use. At the same time, we continue to look for opportunities to deregulate by removing the burden imposed on our customers by unnecessary and obsolete obligations. Our current work includes:

- **Stamp duty land tax (SDLT) deregulation:** The Pre-Budget Report invited representations on deregulatory measures for stamp duty land tax. HMRC received numerous suggestions, many of which are being implemented in this Budget. We will be clarifying the definition of 'chargeable consideration' to resolve areas of doubt over the scope of SDLT, and will be simplifying some aspects of the treatment of leases, trusts and partnerships. This will remove certain transactions from the scope of SDLT altogether. Other suggestions will take longer to plan and implement and we will continue to work with our stakeholders on these and other possible future measures.
- In our **excise regimes** we are:
 - withdrawing or simplifying more than 40 pieces of primary and secondary alcohol duty legislation to remove unnecessary restrictions on commercial freedoms and reflect the modern commercial environment in which the excise industries operate;
 - making changes to the amusement machine licence duty licensing system, that make it simpler and cheaper to amend the number of machines licensed for play;
 - improving conditions for storage, sale and delivery of tobacco product under duty suspense, giving logistical benefits to tobacco manufacturers; and
 - undertaking a radical review of the excise duty deferment guarantee system. Subject to further consultation on the details, we plan to introduce the new system during 2006-07, delivering considerable cost savings for compliant businesses and potentially opening up the deferment system to many more businesses.

We shall continue to work towards further deregulation of excise over the coming months.

2.53 Budget 2006 announced that, in response to representations and building on the simplification of the abolition of the Non-Corporate Distribution Rate for companies, the Government will continue to review the tax and national insurance structure to ensure that small businesses are taxed fairly, whatever their legal form. The Chancellor also announced that he will respond to representations to examine the scope for further alignment of income tax and national insurance

contributions with a view to bringing forward proposals for consultation after the Pre-Budget Report.

- 2.54 The development of a new **HMRC Management Act** will provide a modern, simpler and more consistent legislative framework for the administration of all the main taxes, which will be easier to understand and comply with. It will remove unnecessary complexity and reduce the compliance burden on taxpayers and their advisers. Consultation is a key part of the creation of the New Management Act. HMRC will continue to consult widely on draft clauses later this year.
- 2.55 Following discussions with business when preparing the **2005 revaluation of business rates**, the Valuation Office Agency (VOA)¹² made a number of improvements with the aim of getting the rating valuations "right first time". A National Ratepayer Valuation Forum (NRVF) and four Local Ratepayer Valuation Forums (LRVF) were set up to help develop a range of initiatives to clarify and make the business rates process and individual rating assessments more transparent and easier for business ratepayers to understand.
- 2.56 For example, last year, six months prior to the new rating lists going live, the VOA published 1.49 million summaries of individual rating valuations, promoting confidence that the proposed new rating assessments were fair and in line with similar local properties. In addition, twenty-two new helpdesks were set up, with a dedicated web based "one stop" information service - "mybusinessrates.gov.uk" - which was aimed at giving business, particularly small business, a facility to estimate their 2005 rate bill and provide more certainty in their financial planning. The site received over 100,000 "hits" in its first six months of operation.

¹² The Valuation Office Agency is an executive agency of HMRC